ANNUAL REPORT

TO MARCH 31, 1987

NOVA SCOTIA RESOURCES LIMITED

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NOVA SCOTIA RESOURCES LIMITED

Management Commentary

The following commentary may assist in avoiding misunderstanding when reading our Consolidated Financial Statements for the year ended March 31, 1987.

Effect of Changing Prices on Offshore Costs

During the 12 months prior to March 31, 1987 world oil prices decreased by more than 50%. At the same time, the Canadian Institute of Chartered Accountants (CICA) issued a new Guideline on Full Cost Accounting in the Oil and Gas Industry. For "pre-production" companies such as NSRL, whose principal exploration lands have not yet commenced commercial production, the CICA recommended (a) accumulation within a single "cost centre" of all costs incurred within the country (b) capitalization of all such costs excepting any costs considered unlikely to be recovered out of estimated future net production revenues.

NSRL, in continuing to follow CICA recommendations, changed its accounting policy to meet this Guideline (see Note 1(b)) and employed a "ceiling test" to determine whether its accumulated offshore costs exceed the estimated future net revenues from the area.

Utilizing forecasts and assumptions of future prices, costs and relevant conditions which NSRL's auditors agree to be reasonable, the Company concluded that the costs currently capitalized as petroleum and natural gas investment can be recovered from future net revenues from offshore production.

World oil prices have increased subsequent to the period covered by these financial statements.

Net Cost of Offshore Investment

It is pointed out that at March 31, 1987, NSRL's total net cost of offshore investment, financing, exploration and development to date was $110.9 million. By comparison, one year earlier this cost was $107.3 million.

"Net cost of offshore investment" is calculated by deducting from corporate liabilities the Company's cash on hand, liquid assets and receivables, all as shown on the Balance Sheet. Excluded is the cost of onshore gold exploration, and the Company's 1985 production carveout which was self-financed without corporate liability.

Table of Contents

President's Message....1

Special Review
- The Past Five Years....2
- The Next Five Years....4

Operations 1986/87
- Oil and Gas Exploration....6
- Gold Exploration....9
- Financial....9

Consolidated Financial Statements....11

CORPORATE PROFILE

A Crown corporation of Nova Scotia established in 1981 to invest in and manage the Province's interests in petroleum, energy and mineral resources development and related industrial projects

Holds interests in key oil and gas discoveries and petroleum rights offshore Nova Scotia, including the Venture Gas Project and the Cohasset and Panuke oil structures

Actively exploring for gold in Nova Scotia

1986/87
OPERATING HIGHLIGHTS

- participated in the Thebaud C-74 well which flowed natural gas from 7 zones, and in the Panuke B-90 oil discovery

- acquired all petroleum assets of Sulbath Exploration Limited offshore Nova Scotia

- progressed toward establishing technical basis for Cohasset oil development

1986/87
FINANCIAL HIGHLIGHTS

- federal government will provide $25 million to assist future NSRL offshore drilling activity

- successful $110 million (U.S.) corporate refinancing in Europe has retired bank loans and provides low cost working capital

PRESIDENT'S MESSAGE

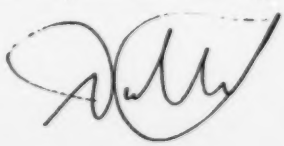
Peter A. Outhit
President and
Chief Executive Officer

As 1987 progresses, international oil markets are stabilizing and the upward price trend has exceeded expectations. The oil and gas industry has begun to emerge from its "survival strategy" retrenchment, essentially the deferral of all non-critical investment. Expenditure budgets for the last quarter 1987 and for 1988 should reflect renewed business confidence and more objective investment criteria.

Despite the worldwide slowdown, a modest level of exploration continued in the Nova Scotia offshore. This resulted in the prolific Thebaud C-74 gas well, which flowed gas from 7 zones, and the important Panuke B-90 oil discovery. NSRL participated in both wells.

During 1986, NSRL expanded and consolidated its key land and asset position on the Scotian Shelf, while concluding Cohasset oil reservoir studies in support of early production from the structure. The Company also took advantage of an opportunity to initiate a new floating rate financing in Europe, which paid out its bank loans and is providing low cost working capital.

The oil industry upheaval of 1986 occurred at a pivotal point in NSRL's six year history. This Annual Report features a review of our corporate activities over the last five years and our strategic objectives for the next five, all in the context of past and forecast oil and gas prices and industry response. It illustrates the rationale behind NSRL's selection of its initial goals, and why we intend to pursue a more proactive business strategy.



June 1987

THE PAST FIVE YEARS

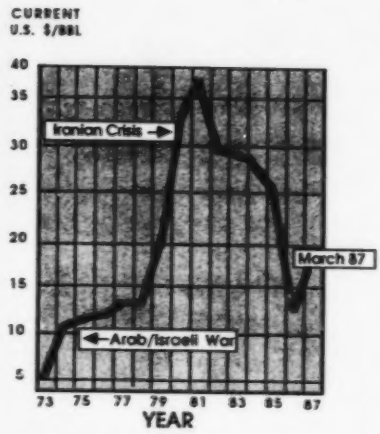


Fig. 1 - Annual Average FOB Cost of U.S. Crude Oil Imports

Global Context

Through its offshore assets and acquired technical base, NSRL is in a position to stimulate the nature and pace of offshore activity. The Company's strategy can be seen in the dramatic context of the last five years, and measured against its expectations for the next five.

In spring 1982 NSRL became committed to offshore oil and gas development by its purchase of major properties on the Scotian Shelf. This coincided with signature by the Nova Scotia and federal governments of the pioneering co-operative Accord on Offshore Resources Management and Revenue Sharing.

The years 1981-85 were characterized by a feverish pace of worldwide oil and gas exploration. Its rationale was traceable to the two world oil shocks of 1973 and 1979 that culminated in a 1981 international oil price of $38 U.S. per barrel (fig. 1). Most energy analysts predicted a doubling of prices by 1990.

The anticipation of this rate of price growth, the impact of real and anticipated energy shortages, and the expectation of high profits drew the oil and gas industry to unprecedented levels of investment, while governments hastened to implement windfall profit-taking regimes rooted in the same assumptions.

As a result, large volumes of non-OPEC oil and gas production were brought onstream even while the higher prices were encouraging conservation and commodity substitution that decreased petroleum product demand. The OPEC share of "free world" oil production plummeted from 56% in 1973 to 30% in 1985.

To retain its shrinking market position, Saudi Arabia used its low cost productive capacity to sell on a "netback" basis that forced the international oil price collapse of first half 1986. Cheap oil, however, created three effects:

- 1986 world oil consumption increased significantly over 1985
- the capacity of the petroleum industry, particularly in the United States, was severely eroded. Oil and gas well completions in the U.S. fell far below 1981-85 levels and the decline is expected to continue through 1987.
- North America is becoming more dependent on OPEC and foreign oil, as it was in the late 1970's. In 1986, U.S. oil imports increased by more than 1 million barrels per day over imports in 1985 (fig. 2).

Canadian Offshore

The 1981-85 federal PIP regime was unprecedented in the magnitude of cash incentives to encourage industry to pursue high-cost exploration, in frontier areas and offshore at ever-deepening water and target zone depths. In the Nova Scotia offshore, 33 wells were drilled within 4 years, averaging 200 days in length (versus 70 days previously). Only 8 were terminated at a depth shallower than 16,000 feet.

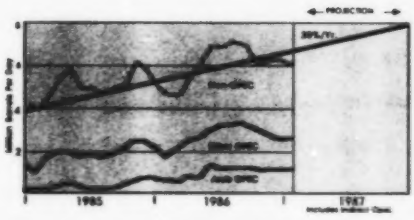


Fig. 2 - U.S. Petroleum Imports by Source

This resulted in 9 new hydrocarbon discoveries, the addition of 5-6 trillion cubic feet of indicated natural gas reserves on the Scotian Shelf, full delineation of Venture Gas Project structures, and commencement of project predevelopment and marketing work.

According to the Canadian Petroleum Association, the 1986 upheaval reduced Canadian offshore drilling activity by 40% over 1985 and total footage drilled by 55%. But the slowdown in the Nova Scotia offshore was offset by such positive factors as:

- industry interest in the 1986 significant light oil discoveries at Cohasset and Panuke, both accessible shallow water locations
- the fact the "PIP-grandfathered" expenditure period overlapped introduction of more stringent short-term exploration requirements under the new Canada Petroleum Resources Act
- advent of a post-PIP tax regime that allows a current taxpaying explorer to recover 60% of its costs
- continuing rapid reduction in well cost due to declining drilling rates and a marked increase in drilling efficiency
- by late 1986, the perception of coming oil and gas shortages and rising prices in North American markets.

NSRL Objectives Since 1981

The Company's mandate has been to represent Nova Scotians in offshore oil and gas development; to influence resource investments to maximize Nova Scotia benefits; and to achieve industry-level returns on investment. Its business strategy has had five objectives:

- to own an interest in every significant discovery
- to be accepted by industry as a valuable partner
- to initiate desirable resource investments
- to acquire key technical information
- to develop its own operating expertise.

Since 1982 NSRL has participated in 24 offshore wells, with a 67% success ratio. It has earned or purchased interests in nearly all Scotian Shelf discoveries, owning an average 6.3% of 7.5 tcf indicated natural gas reserves and approximately 25%-40% of indicated oil reserves in the Cohasset and Panuke fields.

The Company holds a 10% interest in the Venture Gas Project, and has the right to acquire 50% ownership of the offshore and onshore gas pipeline system. It initiated the successful drilling of the Cohasset and Panuke oil structures; developed a partnership with Inco Limited which led to offshore drilling and the onshore SCOMINEX gold exploration project; and operated a major offshore seismic project, the data from which is central to Sable area oil exploration.

NSRL has acquired its assets at an efficient net cost. Careful financial management has sustained a low rate of capital debt growth, and the Company is in a stable financial position.

THE NEXT FIVE YEARS

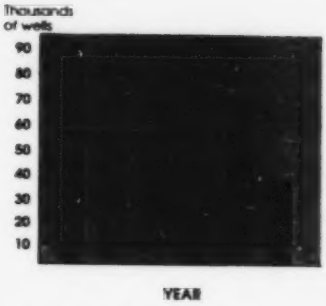


Fig. 3 - Exploration and Development U.S. Well Completions 1981-1986

Global Context

World oil prices have risen to levels above $18 U.S. per barrel. OPEC has returned to a fixed price and controlled output formula designed to preserve its market share while permitting production of non-OPEC oil and gas within ascertainable cost limitations. OPEC appears to have learned that maintaining low production and higher prices is more rewarding than higher productions and lower prices, and that its goals are achieved if it acts cohesively.

We therefore believe, as indicated last year, that the real price of oil will continue its steady upward trend. Short-term prices will always be subject to seasonal swings and current supply/demand situations; but over the longer term, prices will tend to equal the cost of new incremental oil developments. Our trend forecast indicates oil prices in the range of $25 U.S. per barrel (1986 $) by the end of 1992.

North America's decline in conventional oil exploration and development activity (fig. 3) and reduced industry exploration productivity (fig. 4) will make it increasingly difficult for Canadian refineries to acquire adequate Canadian supplies of light crude oil feedstock. By the early 1990's Canada could significantly increase its dependence upon oil imports.

Natural gas markets in the United States continue to bear a deliverability surplus, complicated by a maze of new regulatory rules designed to increase competitive forces in the gas market place. We believe the surplus deliverability conditions will rapidly disappear over the next 2-3 years, and that gas prices will begin to rise at a rate faster than the price of oil until a competitive equilibrium is obtained.

Within the next five years we anticipate markets in the northeast U.S. will experience shortages in peak winter gas supplies; gas and electric utilities have begun to seek long term supply sources as they look at future demands on their systems. New incremental capacity will require the support of secure long term gas contracts in order to receive state and federal regulatory approval. Natural gas will also become more attractive as a large industrial fuel. Accelerating environmental concerns will require power-generating plants to utilize clean natural gas and anticipated new gas usages should increase and broaden residential and commercial consumption. Thus the early 1990's will provide strong markets for Scotian Shelf gas.

Canadian Offshore

Industry expenditure plans for 1987 were finalized in summer 1986 based on expectations that oil prices would not exceed $15 U.S. per barrel. By fourth quarter 1987 the upward price adjustments and a confidence that market stability has returned should lead to expanded 1988 exploration plans. These will take into account the Canada Petroleum Resources Act requirement that exploration agreements be promptly drilled or surrendered. Many attractive shallow water, shallow zone oil and gas prospects remain in the Nova Scotia offshore.

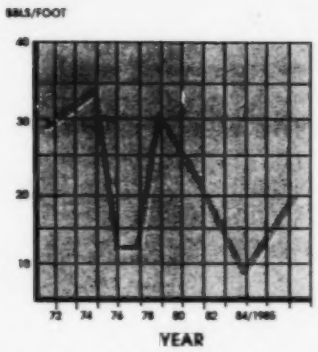


Fig. 4 - U.S.A. Successful oil wells: Average reserve additions per foot drilled

Accordingly, a reasonable level of exploration activity should occur in 1988 and subsequently, driven by industry fundamentals.

The governments of Canada and the United States have also stated their commitment to "security of supply" in the face of rising oil prices and growing dependence on imports. This implies tangible support for new supply projects, assuming such projects are basically viable and that the total cost to all parties is manageable.

Relatively low cost and technological simplicity supports the candidacy for early development of the Nova Scotia offshore. NSRL believes, based on extensive analyses, that small oil fields such as Cohasset are clearly economic at less than $20 U.S. per barrel (1986 $). Gas fields, which require larger reserves, several production platforms and major pipeline and processing facilities, should be economically attractive at prices in the vicinity of $25 U.S. per barrel (1986 $). Government project assistance would be designed to offset technical risk and advance project timing.

NSRL Objectives

In the context described, the Company has a strategic plan to accomplish four goals. These are to stimulate and achieve early offshore production; to secure early drilling of key oil and gas structures; to diversify its cash flows; and to retire all corporate borrowings within a reasonable time frame.

NSRL's primary goal today is to achieve early production from Cohasset, together with the Panuke oil structure, if planned 1987 Panuke appraisal work confirms expectations.

NSRL has committed funding and expertise to develop a supportable technical base that will advance the timing of a decision by the Cohasset interest owners to move to the construction phase.

Net revenues generated over a 4-7 year period from Cohasset/Panuke would provide full NSRL equity funding for the Venture Gas Project development as well as reduce general borrowings. Forecast net revenues from the Venture Gas Project would retire all remaining corporate debt and thereafter provide the Company major long-term cash flows.

In stimulating the early drilling and appraisal of selected targets, NSRL will continue to increase its working interest in key lands, while maximizing its technical and informational base. This proactive strategy will ensure that NSRL's new $25 million drilling fund provided for this purpose will be efficiently utilized.

In seeking to increase a diversified cash flow, the Company intends to use its growing tax pool asset, which will reduce acquisition costs and increase net return from revenue-generating properties.

OPERATIONS 1986/87

OIL AND GAS EXPLORATION

During the year the Company participated in two wells on the Scotian Shelf, both of which discovered significant volumes of hydrocarbons.

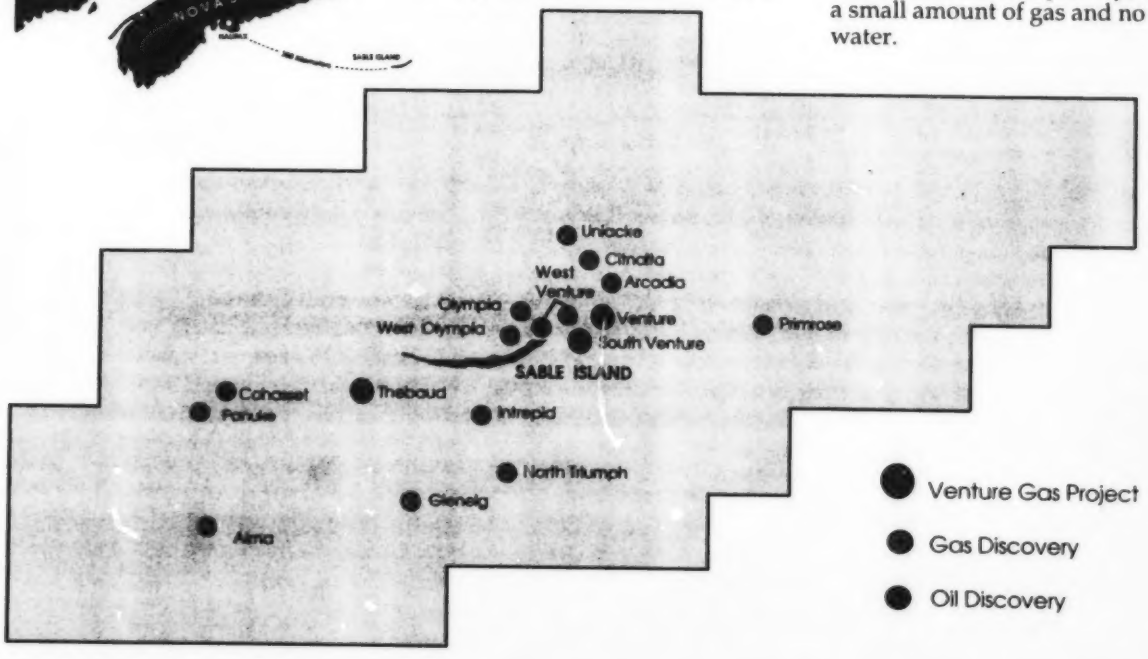
Thebaud C-74, an exploration/delineation well spudded by Mobil on the Thebaud gas-bearing structure (part of the Venture Gas Project), was completed September 30, 1986. It flowed natural gas from 7 of 8 zones tested at individual rates up to a maximum of 47.6 million cubic feet per day, with varying amounts of condensate.

Gas flows from 5 of the 7 zones were from deeper sands not previously productive of hydrocarbons. The combined gas flows make Thebaud C-74 one of the most prolific gas wells drilled in the Nova Scotia offshore, and indicates an addition to recoverable gas reserves in the structure.

Thebaud C-74 was the third appraisal well on the structure and was drilled to a total depth of 5150 meters (16,897 feet). The Company held a 10% interest in the well, which was PIP-grandfathered.

The Shell PCI et al. Panuke B-90 well was drilled by Shell Canada at a location 10 km southwest of the Cohasset A-52 oil discovery, southwest of Sable Island. It was spudded August 6, 1986 in 48 meters of water, with the objective of evaluating oil-bearing potential in the lower Logan Canyon, Missisauga and Abenaki formations. Drilled to a total depth of 3445 meters (10,680 feet), it encountered a number of thin oil-bearing zones.

Testing was carried out on one zone which flowed 56° API (light) gravity oil at a maximum rate of 6,096 barrels per day, with a small amount of gas and no water.



Scotian Shelf Significant Discoveries in which NSRL has interests

NSRL earned a 10% interest in the Panuke structure from Petro-Canada by paying 15% of well costs, which were PIP-grandfathered to the Company. Panuke B-90 is most encouraging to the future development of small-scale oil fields on the Scotian Shelf.

In summer 1986 Mobil concluded negotiations on behalf of its partners for the renewal of Exploration Agreement 255, covering the Sable Island lands excepting those within the Venture Gas Project. Renewal of EA 255 was granted for a period of 3 years from rig release on the Thebaud C-74 well upon the condition that two wells are spudded in the area before the end of the second lease year, or alternatively that rentals are paid for the second year.

Under The Canada Petroleum Resources Act enacted in 1985, all exploration agreement lands revert to the Crown at the end of their term excepting those designated within Significant Discovery Areas.

Mobil has indicated its intention to pursue the drilling of exploration prospects in the Sable Island block in accordance with the requirements of the renewed exploration agreement for the area, in order to establish additional gas reserves.

In March 1987, Canterra Energy Limited announced plans to drill Whycocomagh N-90, the first exploration well on EA 270 issued in 1985, operated by Canterra. The well, located 15 km from the Shell gas discovery at Alma and 25 km from the Shell gas discovery at Glenelg southwest of Sable Island, is to be commenced about April 20, 1987 and drilled to a depth of 3,500 meters (10,850 feet).

The Company holds a 15% working interest in EA 270 and in Whycocomagh N-90, which is the last PIP-grandfathered well on the Scotian Shelf.

Award of Posted Lands

In spring 1986 the Canada/Nova Scotia Oil and Gas Board requested industry nomination of offshore land blocks to be posted for bidding. Based on its extensive seismic and well information bank and its strategy to pursue the exploration of potential oil structures, the Company nominated lands to be posted and held discussion with several companies to assemble a group to bid on posted lands.

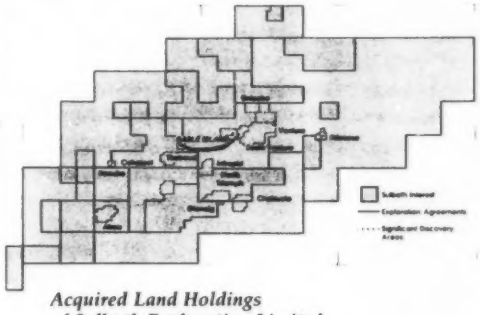
In October 1986, the Board awarded a land block known as Parcel 3 to a group comprising Petro-Canada (50%) NSRL (40%) and Canterra Energy (10%). The Company believes that Parcel 3 (the "West Panuke Block") contains a significant portion of the Panuke oil structure discovered by the Panuke B-90 well and that accordingly it contains reserves of oil in place. This block will be evaluated by future appraisal drilling on the Panuke structure.

Acquisition of Sulbath Exploration Interests

On October 1, 1986 the Company purchased all the assets of Sulbath Exploration Limited in the Nova Scotia offshore.

These principally comprise small working interests throughout the attractive Shell-operated lands in the Sable Island area, including a 2.5% interest in gas reserves established in the North Triumph, Alma and Glenelg structures and a 2.5% interest in the Panuke oil-bearing structure.

Through this acquisition NSRL has become a participant in the Shell joint ventures and an interest owner in nearly all hydrocarbon discoveries on the Scotian Shelf.



Acquired Land Holdings of Sulbath Exploration Limited

Cohasset Oil Project

During the year, pre-development work was carried out by Petro-Canada as Operator and by NSRL as a major interest owner, with the objective of confirming the technical and economic feasibility to bring the Cohasset structure into oil production.

In March 1986 the third well on the structure, Cohasset A-52, tested combined flows from 6 zones of 29,000 barrels per day of light gravity oil. Interests in the A-52 well are held by Petro-Canada (66%), NSRL (25%) and Canterra Energy (9%). Cohasset is located in 120 feet of water, 25 miles southwest of Sable Island, in lands in which Mobil Oil Canada, Ltd. also holds a significant interest.

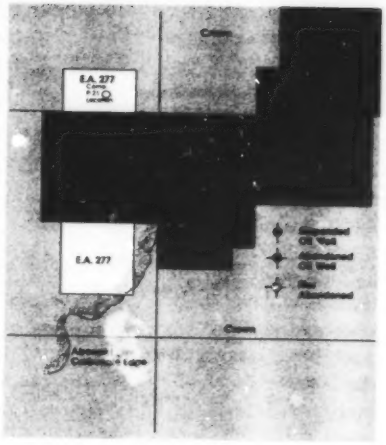
Having initiated the successful drilling of Cohasset A-52, the Company has dedicated a technical team to develop a conceptual engineering base for reservoir calculation and facilities design. This team undertook an intensive program July-December 1986 to re-evaluate all seismic data so as to enable oil in place to be calculated. NSRL also initiated background studies on facility design criteria and computer modelling to project production performance and field economics.

In July 1986 the Company joined with Petro-Canada to conduct a 3-D seismic program over the reservoir that was of great value in defining structural reserves and optimizing well locations, thereby reducing development drilling risks. In December the Company and Petro-Canada jointly concluded their work on the reserves and reservoir characteristics.

In early 1987, Petro-Canada proceeded with plans to prepare, jointly with NSRL, a production strategy leading to conceptual facilities design. This work is currently scheduled for completion in September 1987.

NSRL's economic analyses confirm Cohasset's commercial potential at world oil prices of U.S. $18 per barrel. Its studies confirm that under various design alternatives field facilities can be assembled in Nova Scotia using standard technology, so that production could commence within 20 months of receipt of government approval to construct.

In 1987 NSRL plans to complete the preliminary technical work and to initiate discussions to



secure a satisfactory fiscal framework that would support a development decision by the Cohasset interest owners.

Panuke Oil Structure

The Panuke B-90 oil discovery of September 1986 is encouraging for the early development of Cohasset. The nature of the productive sand encountered at Panuke, the compatibility of tested oil with Cohasset oil flow, and the proximity of the two fields indicates the potential of Panuke to be a source of important additional production through Cohasset at a relatively low development cost.

The Company has commenced conceptual studies to confirm the possibility to produce the Panuke structure through a seafloor template, tied by pipeline to the Cohasset processing and transshipment facilities.

A Panuke appraisal well will be required to confirm the integrity and extent of its producing sands. The Company is hopeful this appraisal well can be drilled in 1987.

The Company holds a 12.5% working interest in the Panuke structure, having earned 10% by participation in the B-90 well and having purchased a 2.5% interest from Sulbath Exploration Limited. The Company anticipates its interest in the structure will increase through its 40% ownership of the West Panuke block awarded in fall 1986.

Venture Gas Project

As a consequence of the economic uncertainties created by world oil market instability, most new pre-development work in the Mobil-operated Venture Gas Project, in which the Company holds a 10% interest, was deferred pending price recovery.

Nevertheless, Project activities carried out during the year included documentation and updating of detailed descriptions of established gas reserves in the Venture, South Venture and Thebaud structures, technical studies of alternative methods of production and development, and certain third party studies not dependent on ultimate system design. Potential deeper gas reserves indicated by the Thebaud C-74 gas well in September 1986 are being studied to determine the extent of reserve additions.

This work is being incorporated in a revised Venture Development Plan, due to be completed in fall 1987.

Technical exchanges and discussions took place between Mobil and Shell Canada, operator of adjacent land blocks that contain the North Triumph, Glenelg and Alma gas-bearing structures.

GOLD EXPLORATION

During 1986-87, the Scotian Mineral Exploration Joint Venture ("SCOMINEX"), formed in 1984, managed by Inco Limited and in which the Company directly and through its subsidiary COREL has held a 25.8% interest, completed its second full year of province-wide gold exploration.

SCOMINEX's objective is to explore for large tonnage gold deposits of economic significance. It is committed to expend a minimum of $3 million in exploration over the years 1985-86-87, and currently holds four major properties covering 5,290 claims comprising 211,600 acres throughout Nova Scotia.

In 1986 preliminary reconnaissance surveys including geological mapping, geochemistry and geophysics were conducted for SCOMINEX in Southeast Cape Breton, the East Bay Hills, the Antigonish Highlands and Cape Breton Highlands.

During the year, a 4,500 ton underground bulk sample was extracted from the gold bearing Cochrane Hill deposit, which SCOMINEX holds under option, in Guysborough County. The purpose of this project was to investigate the mineability of the deposit and the continuity of the gold bearing horizons, with the aim of determining an accurate overall grade, and conducting gold recovery tests. At the time of writing, the results were being assessed by Inco prior to making its report to SCOMINEX regarding further work.

Diamond drilling was carried out in the East Bay Hills in Cape Breton, where five holes were drilled for a total of 480 meters. Anomalous gold values were encountered in three of the holes, and follow-up work is planned for the 1987 season. Encouraging results were also received from the Cape Breton Highlands, where substantial further work will be conducted in 1987. This will consist of detailed mapping, geochemical sampling, trenching, and an airborne geophysical program leading to diamond drilling.

In addition, a further 2,210 claims were staked in a new area called Southwest Cape Breton, where geochemical sampling and prospecting will be carried out in summer 1987.

In March 1987, NSRL acquired the entire equity of Inco in COREL, so that the Company's entire 25.8% interest in SCOMINEX is now directly held by NSRL.

Mineralized zone, underground Cochrane Hill

FINANCIAL

Corporate Refinancing

During the year the Company decided, after an extensive review, to refinance its existing bank borrowings and to enter a new financial market that would also provide low cost capital funding for future activities.

Accordingly, in November 1986 the Company commenced a program to issue in the Euro-commercial paper market short-term promissory notes, guaranteed by the Province, to a maximum of $110 million (U.S.) Under this program, selected dealers bid competitively to place the Company's notes at the most attractive rates, the purchasers being institutional investors, banks and other companies active in the Euro-CP market. The notes are denominated in U.S. dollars and are usually issued in blocks of $2 million to $10 million.

Through this innovative method, the Company and the Province have been introduced to a major financial market and NSRL is able to develop its own investor base. The notes have been well received. The appointed dealers, based in London, England, are Citicorp Investment Bank Limited, Merrill Lynch International and CIBC Limited.

Proceeds of the notes have been used first to pay out the Company's existing bank loans, which was achieved in February 1987, and then to provide working capital for future exploration activities.

To March 31, 1987, the average cost of obtaining floating rate funding in the Euro-CP market was significantly below LIBOR (London Interbank Offering Rate). This is expected to produce interest expense savings to the Company of more than $700,000 per year.

Close monitoring of international money markets, essential to Euro-CP program management.

$25 Million Drilling Fund

Negotiations between Nova Scotia and the federal government to revise the 1982 Canada/Nova Scotia Agreement on Offshore Resource Management and Revenue Sharing (the "1982 Agreement") were concluded in summer 1986 with the Canada/Nova Scotia Offshore Petroleum Resources Accord.

At a special ceremony in Halifax on August 26, 1986 the Accord was signed by Prime Minister Brian Mulroney and the Honourable Marcel Masse, Minister of Energy, Mines and Resources, on behalf of the federal government, and by Premier John Buchanan and the Honourable Joel Matheson, Minister of Mines and Energy on behalf of the Province.

Article 36 of the Accord provides: *"The parties agree that Canada shall make available to Nova Scotia Resources Limited (NSRL) an amount of $25 million for the purpose of facilitating the drilling and development of wells that could contribute to early oil and gas development in the offshore area.*
(a) Funds will be available to NSRL to defray 50% of costs classified as Canadian Exploration Expenses (CEE) or Canadian Development Expenses (CDE) as set out by the federal Income Tax Act for wells spudded or for development activities undertaken prior to December 31, 1989.
(b) Funds will be advanced to NSRL on an as-needed basis as agreed by both Ministers."

The purpose of the fund, which partially compensates Nova Scotia for the negotiated removal of its "Crown share" rights under the 1982 Agreement, was to place NSRL on an equal net cost footing with taxpaying explorer companies able to utilize income tax allowances. In designating this fund to NSRL, both governments have recognized the Company's important role in the development of the Nova Scotia offshore.

Canadian Exploration and Development Incentive Program (CEDIP)

On March 25, 1987 the federal Minister of Energy, Mines and Resources announced the CEDIP incentive program, designed to provide cash grants to the petroleum industry of up to 33.33% of up to $10 million per year of eligible exploration and development expenses.

The Company is eligible to receive CEDIP with respect to its offshore drilling activities, reducing further its net exploration and development costs.

Flow-through Share Capability

In 1986, the Company established an internally-owned limited partnership within which it may accumulate its 1987 exploration expenditures. This provides to the Company the option to eventually flow through such expenditures to outside investors under the Income Tax Act, and thereby further reduce the Company's net exploration costs.

Based on the level of offshore expenses accumulated in 1987, the Company will make a determination late in the year whether to utilize the flow-through share structure. Should the Company decide not to do so, its operations will be unaffected by the existence of the limited partnership.

Cash Generating Properties

Having utilized its growing tax pools in 1985 to conclude a petroleum production purchase transaction which has generated significant cash flow to the Company, a number of potential cash flow acquisitions were examined in 1986 based on utilization of NSRL's tax pools. This policy will be pursued in 1987.

FINANCIAL

AUDITORS' REPORT

To the Shareholders of
Nova Scotia Resources Limited

We have examined the consolidated balance sheet of Nova Scotia Resources Limited as at March 31, 1987 and the consolidated statements of income and deficit and changes in financial position for the year then ended, and have obtained all the information and explanation we have required. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion and according to the best of our information and the explanations given to us and as shown by the books of the company, these consolidated financial statements are properly drawn up so as to exhibit a true and correct view of the financial position of the company as at March 31, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles and applied on a basis consistent with that of the preceding year except for the change in accounting policy, with which we concur, as explained in Note 1 (b).

Doane Raymond

Chartered Accountants

Halifax, Nova Scotia
May 22, 1987

NOVA SCOTIA RESOURCES LIMITED
CONSOLIDATED BALANCE SHEET
MARCH 31, 1987

ASSETS

	1987	1986
Current		
Cash and term deposits	$ 11,596,181	$ 11,335,174
Receivables	3,364,725	7,251,286
	14,960,906	18,586,460
Petroleum and natural gas investments (note 2)	117,344,510	114,408,643
Mineral properties (note 3)	668,558	493,711
Equipment and leasehold improvements	85,000	109,585
Other assets	3,887	4,176,253
	$133,062,861	$131,774,652

LIABILITIES

Current		
Commercial paper (note 4)	$125,616,801	$
Bank indebtedness		46,764,523
Payables and accruals	447,656	5,594,788
Deferred grants	461,886	362,528
Current portion of long term debt	1,200,000	1,840,000
	127,726,343	54,561,839
Long term debt (note 5)	6,717,103	81,117,320
Minority interest	134,443,446	135,679,159
		3,281,236

SHAREHOLDERS' DEFICIENCY

Capital stock		
Authorized		
40,000 common shares without par value		
Issued and outstanding		
3 common shares	3	3
Deficit	(1,380,588)	(1,185,746)
	(1,380,585)	(1,185,743)
	$133,062,861	$137,774,652

ON BEHALF OF THE BOARD

---------- Director

---------- Director

NOVA SCOTIA RESOURCES LIMITED
CONSOLIDATED STATEMENT OF INCOME AND DEFICIT
YEAR ENDED MARCH 31, 1987

	1987	1986
Income		
Petroleum and natural gas (note 6)	$ 4,251,666	$ 7,423,723
Royalties	(675,887)	(2,333,815)
	3,575,779	5,089,908
Interest	1,031,523	1,029,115
Other	48,637	48,725
	4,655,939	6,167,748
Expenses		
Petroleum and natural gas operating expenses	717,028	992,097
Non-capitalized financing charges	1,599,316	2,753,312
General and administrative	566,994	544,489
Depletion and depreciation	1,672,927	2,309,302
Petroleum and gas revenue tax		170,761
Write-off of petroleum property		2,012,720
Loss from coal resource operations (note 7)	294,516	317,424
	4,850,781	9,100,105
Loss before income taxes recovered	(194,842)	(2,932,357)
Income taxes recovered		983,317
Net loss	(194,842)	(1,949,040)
Retained earnings (deficit), beginning of year	(1,185,746)	763,294
Deficit, end of year	$(1,380,588)	$(1,185,746)

NOVA SCOTIA RESOURCES LIMITED
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR ENDED MARCH 31, 1987

	1987	1986
Cash provided from (used for) operations		
Net loss	$ (194,842)	$ (1,949,040)
Depreciation and depletion	1,672,927	2,309,302
Deferred income taxes		(812,556)
Write-off of petroleum property		2,012,720
	1,478,085	1,560,426
Changes in		
Receivables	3,886,561	4,281,353
Payables and accruals	(5,147,132)	2,843,021
Deferred grants	99,358	(10,146)
	316,872	8,674,654
Cash provided from (used for) financing		
Proceeds from commercial paper	125,616,801	
Proceeds (reduction) of long term debt	(75,040,217)	21,607,793
Increase (reduction) in bank indebtedness	(46,764,523)	8,227,727
Decrease (increase) in unamortized foreign exchange loss	4,168,102	(3,755,296)
Repayment of other loans		(262,583)
Decrease (increase) in other assets	(185,483)	18,164
Minority interest	(3,281,236)	530,729
	4,513,444	26,366,534
Cash used for (provided from) investing		
Purchase of		
Petroleum and natural gas properties	500,000	
Mineral properties	174,847	335,606
Equipment and leasehold improvements	933	
Cost incurred on petroleum and natural gas properties		31,883
	3,893,529	36,010,413
	4,569,309	36,377,902
Net cash provided (used)	261,007	(1,336,714)
Cash and short term deposits, beginning of year	11,335,174	12,671,888
Cash and short term deposits, end of year	$ 11,596,181	$ 11,335,174

NOVA SCOTIA RESOURCES LIMITED
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 1987

1. Accounting policies

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries.

A significant part of the Company's activities is conducted jointly with others and accordingly, the accounts reflect only the Company's proportionate interest in these activities.

(b) Petroleum and natural gas investments

The Company follows the full cost method of accounting for pre-production companies as prescribed in the Guideline on Full Cost Accounting in the Oil and Gas Industry issued by the Canadian Institute of Chartered Accountants (the "CICA Guideline"). All costs of acquisition, exploration for and development of petroleum and natural gas reserves are capitalized and accumulated in one cost centre. Costs capitalized include overhead related to exploration and development activities, as well as interest and foreign exchange gains and losses related to funds borrowed for these activities. The amount of Petroleum Incentives Program grants earned is accounted for as a reduction of exploration expenditures.

Depletion expense for exploration activities is not calculated until such time as production commences. Depletion expense for producing properties in Western Canada is calculated based upon the unit-of-production method.

Prior to April 1, 1986, the Company accumulated the cost of petroleum and natural gas investments in several cost centres. During the current year this policy was changed as permitted under the recommendations of the new CICA Guideline to account for all interests within a country as a single cost centre. As a result of this change, the net loss for the year has been reduced and petroleum and natural gas investments have been increased by $4,086,979. Prior years have not been restated for the change in accounting policy.

(c) Mineral properties

The Company follows the full cost method of accounting whereby all costs of acquisition, exploration for and development of mineral reserves are capitalized and accumulated in one cost centre. Costs capitalized include overhead related to exploration and development activities as well as interest and foreign exchange gains and losses related to funds borrowed for these activities.

(d) Foreign currency translation

Assets and liabilities have been translated to Canadian dollars using the exchange rate on March 31, 1987. Transactions during the year are recorded using the exchange rate in effect at the date of the transaction.

(e) Income taxes

The Company follows the tax allocation method of accounting for income taxes in its subsidiary company, whereby deferred taxes are provided to the extent that current taxes have been reduced by claiming capital cost allowance and exploration, development and acquisition expenses in excess of the related depletion, depreciation and amortization provided in the financial statements.

2. Petroleum and natural gas investments

	1987	1986
Offshore Nova Scotia	$109,036,796	$104,875,876
Producing properties, WesternCanada	8,307,714	9,532,767
	$117,344,510	$114,408,643

The cost of the Offshore Nova Scotia properties includes $32.1 million of net financing costs and has been reduced by $68.8 million of Petroleum Incentives Program grants earned.

3. Mineral properties

The Company's investment in mineral properties is represented by its working interest in the Scotian Mineral Exploration Venture (SCOMINEX).

4. Commercial Paper

On October 9, 1986 the Company established a Euro Commercial Paper Programme under which it issues short-term notes with the guarantee of the Province of Nova Scotia up to a maximum aggregate principal amount not exceeding U.S. $110,000,000. The notes are denominated in U.S. dollars and the principal balance outstanding at March 31, 1987 is U.S. $96 million. Proceeds from the note programme have been used to retire bank loans.

Since the short-term notes are revolving on a 30 to 90 day basis they have been classified as current liabilities.

To support the note programme, the Company has arranged a Revolving Underwritten Facility which provides committed bank funding to US $60,000,000. This credit facility has a 5 year term and includes participation by 12 international banks. Repayment of advances is guaranteed by the Province of Nova Scotia. The aggregate principal obligation issued under the Euro Commercial Paper Programme and the Revolving Underwritten Facility cannot exceed US $110,000,000.

5. Long-term debt

In 1985, the Company borrowed $11.1 million to acquire producing oil and gas properties in Western Canada. The loan will be repaid from net revenues from the properties and the lender has no other recourse.

6. Petroleum and natural gas income

In 1985 the Company purchased an interest in certain producing oil and natural gas properties in Western Canada. After all direct expenses, this transaction resulted in a net income of $367,075 for the year.

7. Loss from coal resource operations

Coal mining operations of the Company's wholly owned subsidiary Novaco Limited ceased in 1985 and the loss for the current year represents the cost of reclaiming and restoring lands previously mined.

8. Losses carried forward

The Company, through its subsidiary, Nova Scotia Resources (Ventures) Limited, has losses carried forward for income tax purposes totalling $13.8 million which are due to expire in varying amounts over a period from March 31, 1990 to March 31, 1994 unless applied against taxable income of the Company. The tax benefit related to these losses has not been recognized in these financial statements.

BOARD OF DIRECTORS

Peter A. Outhit
President
Nova Scotia Resources Limited
Halifax, N.S.
CHAIRMAN

Dennis Ashworth
Barrister & Solicitor
Patterson, Kitz

J. Ewart Blanchard
Consultant
N.S. Research Foundation
Corporation
Dartmouth, N.S.

Richard S. Brookfield
President and CEO
Municipal Finance Corporation
Halifax, N.S.

Ronald B. Coleman
President
R.B. Coleman Consulting Co. Ltd.
Calgary, Alberta

H. Purdy Crawford, Q.C.
President and
Chief Operating Officer
Imasco Limited
Montreal, Quebec

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Deputy Minister
N.S. Department of Mines and Energy
Halifax, N.S.

Thomas Lynch
President
Lynch Investments Limited
Halifax, N.S.

James D. McNiven
Deputy Minister
N.S. Department of Development
Halifax, N.S.

Hon. John E. Shaffner
Retired
Port Williams, N.S.

John MacPherson
Principal Assistant to the Premier
Government of Nova Scotia
Halifax, N.S.

PRINCIPAL OFFICERS

President and Chief Executive Officer
Peter A. Outhit
Halifax, N.S.

Secretary
Joseph A.F. Macdonald
McInnes Cooper & Robertson
Halifax, N.S.